

# **ECONOMIC OUTLOOK AND REVENUE ESTIMATES FOR MICHIGAN**

**FY 2003-04  
AND  
FY 2004-05**



**HOUSE**  
**FISCAL**  
**AGENCY**  
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# FOREWORD

The House Fiscal Agency (HFA) is pleased to present this report to members of the Michigan House of Representatives. The purpose of the report is to inform members of the revised General Fund/General Purpose and School Aid Fund revenue estimates for fiscal year (FY) 2003-04 and FY 2004-05. The estimates reported herein will be presented to the Consensus Revenue Estimating Conference on December 3, 2004, and will be used to facilitate the consensus estimating process.

This report includes the House Fiscal Agency's analysis of important factors that will affect state and national economies through the year 2005, estimates of the Countercyclical Budget Stabilization Fund, state compliance with the Constitutional State Revenue Limit, and year-end balance estimates for General Fund/General Purpose (GF/GP) and the School Aid Fund (SAF).

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# EXECUTIVE SUMMARY

This report provides information that will be discussed at the December 3, 2004, Consensus Revenue Estimating Conference.

## **Tables 1 and 2: HFA Recommended Revisions From May 2004 Consensus**

Provides HFA recommendations for revised estimates for FY 2003-04 and FY 2004-05 GF/GP and SAF revenues.

- Total *actual* GF/GP and SAF revenues show a recommended decrease of \$5.4 million (to \$18,524.1) for FY 2003-04.
- Total *actual* GF/GP and SAF revenues show a recommended decrease of \$437.6 million (to \$18,654.5) for FY 2004-05.

## **Table 3: Economic Forecast Variables**

Provides estimates of various state and national economic variables.

- Real gross domestic product (GDP) is forecast to grow 4.4% in calendar year (CY) 2004 and 3.2% in CY 2005.
- Michigan personal income is forecast to grow 2.8% in CY 2004 and 4.5% in CY 2005.

## **Table 4: GF/GP Revenue Estimates**

Provides detail for HFA's December 2004 GF/GP revenue estimates. Total GF/GP *actual* revenues show a decrease of \$167.5 million from FY 2003-04 to FY 2004-05 (from \$7,972.6 million to \$7,805.1 million).

## **Table 5: School Aid Fund Revenue Estimates**

Provides detail for HFA's December 2004 SAF revenue estimates. Total SAF *actual* revenues show an increase of \$297.7 million from FY 2003-04 to FY 2004-05 (from \$10,551.6 million to \$10,849.3 million).

## **Table 6: Year-End Balances**

Provides actual and HFA estimates of year-end balances for GF/GP, SAF, and the Budget Stabilization Fund (BSF). The House Fiscal Agency estimates no balance in the GF/GP, SAF, or BSF for FY 2003-04.

## **BSF Year-End Balance**

No pay-in or withdrawal is estimated for FY 2004-05.

## **Compliance With the State Revenue Limit**

State revenues are estimated to be substantially below the revenue limit for FY 2003-04 (\$4.56 billion) and FY 2004-05 (\$5.64 billion).



# FORECAST REVISIONS AND ECONOMICS

This section provides HFA recommended revisions to the May 2004 consensus forecast, and state and national economic data for calendar years 2002 through 2005 (data for calendar years 2004 and 2005 are HFA estimates).

- Tables 1 and 2 report HFA's recommended GF/GP and SAF revisions for FY 2003-04 and FY 2004-05.
- Table 3 shows the economic data used by the HFA to produce its updated revenue forecasts.

**Table 1**  
**FISCAL YEAR 2003-04 HFA RECOMMENDED REVISIONS**  
(Millions of Dollars)

	<u>Adjusted May 2004 Consensus</u>	<u>Preliminary Final December 2004 Recommendation</u>	<u>Recommended Revision</u>
<b><i>BASELINE</i></b>			
GF/GP	\$8,076.0	\$8,040.8	(\$35.2)
SAF	<u>10,446.3</u>	<u>10,434.5</u>	<u>(11.8)</u>
	<b>\$18,522.3</b>	<b>\$18,475.3</b>	<b>(\$47.0)</b>
<b><i>ACTUAL</i></b>			
GF/GP	\$7,970.4	\$7,972.6	\$2.2
SAF	<u>10,559.2</u>	<u>10,551.6</u>	<u>(7.6)</u>
	<b>\$18,529.6</b>	<b>\$18,524.1</b>	<b>(\$5.4)</b>

*NOTE: Numbers may not add due to rounding.*

**Table 2**  
**FISCAL YEAR 2004-05 HFA RECOMMENDED REVISIONS**  
(Millions of Dollars)

	<u>Adjusted May 2004 Consensus</u>	<u>HFA December 2004 Recommendation</u>	<u>Recommended Revision</u>
<b><i>BASELINE</i></b>			
GF/GP	\$8,417.2	\$8,174.4	(\$242.8)
SAF	<u>10,874.2</u>	<u>10,726.6</u>	<u>(147.6)</u>
	<b>\$19,291.4</b>	<b>\$18,901.0</b>	<b>(\$390.4)</b>
<b><i>ACTUAL</i></b>			
GF/GP	\$8,095.4	\$7,805.1	(\$290.3)
SAF	<u>10,996.7</u>	<u>10,849.3</u>	<u>(147.4)</u>
	<b>\$19,092.1</b>	<b>\$18,654.5</b>	<b>(\$437.6)</b>

*NOTE: Numbers may not add due to rounding.*

**Table 3**  
**ECONOMIC FORECAST VARIABLES**

	<u>Calendar 2002</u>	<u>Calendar 2003</u>		<u>Calendar 2004</u>		<u>Calendar 2005</u>	
	<u>Actual</u>	<u>Actual</u>	<u>Change from Prior Year</u>	<u>Estimated</u>	<u>Change from Prior Year</u>	<u>Estimated</u>	<u>Change from Prior Year</u>
<b><u>United States</u></b>							
Real Gross Domestic Product (Billions of 2000 dollars)	\$10,074.8	\$10,381.3	3.0%	\$10,837.2	4.4%	\$11,185.4	3.2%
Implicit Price Deflator GDP (2000 = 100)	104.1	106.0	1.8%	108.2	2.0%	110.4	2.1%
Consumer Price Index (1982-84 = 100)	179.9	184.0	2.3%	188.9	2.7%	193.5	2.4%
Personal Consumption Deflator (2000 = 100)	103.5	105.5	1.9%	107.8	2.2%	109.7	1.8%
3-month Treasury Bills Interest Rate (Percent)	1.6%	1.0%		1.4%		2.4%	
Aaa Corporate Bonds Interest Rate (Percent)	6.5%	5.7%		5.6%		5.7%	
Unemployment Rate - Civilian (Percent)	5.8%	6.0%		5.5%		5.4%	
Light Vehicle Sales (Millions of units)	16.8	16.6	-1.2%	16.7	0.6%	16.7	0.0%
Passenger Car Sales (Millions of units)	8.1	7.6	-5.7%	7.4	-2.9%	7.4	0.0%
Light Truck Sales (Millions of units)	8.7	9.0	3.4%	9.3	3.3%	9.3	0.0%
Import Share of Light Vehicles (Percent)	19.6%	19.9%		20.1%		20.6%	
Personal Income (Billions of current dollars)	\$8,878.9	\$9,161.8	3.2%	\$9,618.3	5.0%	\$10,150.5	5.5%
Real Disposable Income (Billions of 2000 dollars)	\$7,559.8	\$7,733.7	2.3%	\$7,960.3	2.9%	\$8,217.0	3.2%
<b><u>Michigan</u></b>							
Wage and Salary Employment (Thousands)	4,477.5	4,415.3	-1.4%	4,373.0	-1.0%	4,398.5	0.6%
Unemployment Rate (Percent)	6.2%	7.3%		6.7%		6.8%	
Personal Income (Millions of current dollars)	\$302,019	\$314,460	4.1%	\$323,292	2.8%	\$337,833	4.5%
Real Personal Income (Millions of 1982-84 dollars)	\$168,742	\$172,267	2.1%	\$174,062	1.0%	\$177,631	2.1%
Real Disposable Income (Millions of 1982-84 dollars)	\$148,698	\$153,614	3.3%	\$155,832	1.4%	\$158,478	1.7%
Wages and Salary Income (Millions of current dollars)	\$173,339	\$176,493	1.8%	\$177,680	0.7%	\$184,198	3.7%
Detroit Consumer Price Index (1982-84 = 100)	179.0	182.5	2.0%	185.7	1.8%	190.2	2.4%



# REVENUES AND YEAR-END BALANCES

Revenue estimates are based on the economic performance of key components of national and state economies discussed in the preceding section. This section explains December 2004 House Fiscal Agency revenue estimates for GF/GP and School Aid Fund (SAF) revenue by major revenue sources. It provides revenue estimates, year-end balances for the major funds and the budget stabilization fund, and the state revenue limit calculation.

## ***GF/GP Revenue by Source***

Actual GF/GP revenues take tax changes into account and are available for expenditure each year. *Preliminary final actual GF/GP revenues* were \$7,972.6 million in FY 2003-04; they are forecast to decrease by 2.1% or \$167.5 million to \$7,805.1 million in FY 2004-05.

**Table 4**  
**GF/GP REVENUE ESTIMATES**  
(Millions of Dollars)

	Final	Preliminary Final		Fiscal Year 2004-05 over 2003-04	
	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>% Change</u>	<u>\$ Change</u>
Personal Income Taxes	\$3,955.8	\$4,058.2	\$4,177.0	2.9%	\$118.8
Sales and Use Taxes	883.3	965.6	1,016.8	5.3%	51.2
SBT and Insurance Taxes	2,114.0	2,047.3	2,095.0	2.3%	47.7
Other Taxes	<u>698.9</u>	<u>677.9</u>	<u>666.3</u>	-1.7%	<u>(11.6)</u>
<b>GF/GP Baseline Tax Revenues</b>	<b>\$7,652.1</b>	<b>\$7,749.0</b>	<b>\$7,955.1</b>	<b>2.7%</b>	<b>\$206.1</b>
Non-Tax Revenue	<u>292.7</u>	<u>291.8</u>	<u>219.3</u>	-24.8%	<u>(72.5)</u>
<b>Total GF/GP Baseline Revenues</b>	<b>\$7,944.8</b>	<b>\$8,040.8</b>	<b>\$8,174.4</b>	<b>1.7%</b>	<b>\$133.6</b>
Adjustments to Baseline	<u>14.1</u>	<u>(68.2)</u>	<u>(369.2)</u>	<b>441.3%</b>	<b><u>(\$301.0)</u></b>
<b>Actual GF/GP Revenues</b>	<b>\$7,958.9</b>	<b>\$7,972.6</b>	<b>\$7,805.1</b>	<b>-2.1%</b>	<b><u>(\$167.5)</u></b>

*NOTE: Numbers may not add due to rounding.*

### ***SAF Revenue by Source***

Actual SAF revenues take tax changes into account. *Preliminary actual SAF revenues* totaled \$10,551.6 million in FY 2003-04; revenues are forecast to increase \$297.7 million or 2.8% to \$10,849.3 million in FY 2004-05.

**Table 5**  
**SCHOOL AID FUND REVENUE ESTIMATES**  
(Millions of Dollars)

	Final	Preliminary Final	FY 2004-05	Fiscal Year 2004-05 over 2003-04	
	<u>FY 2002-03</u>	<u>FY 2003-04</u>		<u>% Change</u>	<u>\$ Change</u>
Sales and Use Tax	\$5,091.6	\$5,150.8	\$5,272.7	2.4%	121.9
Income Tax Earmark	1,847.0	1,889.5	1,961.3	3.8%	71.8
State Education Tax	1,673.2	1,721.4	1,820.5	5.8%	99.1
Lottery and Casinos	676.9	691.1	694.3	0.5%	3.2
Tobacco Taxes	489.1	479.6	472.7	-1.4%	(6.9)
Real Estate Transfer Tax	275.5	314.1	315.0	0.3%	0.9
Other Taxes	<u>202.4</u>	<u>187.9</u>	<u>190.1</u>	<u>1.2%</u>	<u>2.2</u>
<b>Baseline SAF Revenues</b>	<b>\$10,255.7</b>	<b>\$10,434.5</b>	<b>\$10,726.6</b>	<b>2.8%</b>	<b>\$292.1</b>
Adjustments to Baseline	<u>459.2</u>	<u>117.1</u>	<u>122.7</u>	<u>4.8%</u>	<u>\$5.6</u>
<b>Actual SAF Revenues</b>	<b>\$10,714.8</b>	<b>\$10,551.6</b>	<b>\$10,849.3</b>	<b>2.8%</b>	<b>\$297.7</b>

*NOTE: Numbers may not add due to rounding.*

### ***HFA Estimates of Year-End Balances***

**Table 6** reports House Fiscal Agency estimates of year-end balances for GF/GP, the SAF, and the BSF for FY 2003-04. Final FY 2000-01, FY 2001-02, and FY 2002-03 figures are also shown.

**Table 6**  
**YEAR-END BALANCE ESTIMATES**  
(Millions of Dollars)

	Final <u>FY 2001-02</u>	Estimated <u>FY 2002-03</u>	Estimated <u>FY 2003-04</u>
General Fund/General Purpose	\$114.5	\$174.0	\$0.0
School Aid Fund	\$237.0	\$113.7	\$0.0
Budget Stabilization Fund	\$145.2	\$0.0	\$0.0

### ***BSF Year-End Balance***

The Counter-Cyclical Budget and Economic Stabilization Fund (BSF), or the state's rainy day fund, is a reserve of cash to contribute to or withdraw from throughout the economic cycles. The BSF trigger calculation, which is based on Michigan personal income less transfer payments adjusted for inflation and actual or net GF/GP revenue, indicates no pay-in or withdrawal for FY 2004-05.

### ***Compliance With the State Revenue Limit***

Article IX, Section 26 of the *Michigan Constitution*, which was approved by the vote of the people in 1978, sets a limit on the amount of revenue collected by the state in any fiscal year. As provided for in the Constitution, the revenue limit is calculated as 9.49% of total state personal income (which is the broadest measure of state economic activity) in the previous full calendar year prior to the fiscal year in which the revenues are measured.

The revenue to be considered in the revenue limit includes not only state taxes, but also fees, licenses, and interest earned. Federal aid is not included in the revenue limit calculation.

Article IX, Section 26, *Constitution of the State of Michigan*, provides that:

. . . For any fiscal year in the event that Total State Revenues exceed the limit established in this section by 1% or more, the excess revenues shall be refunded pro rata based on the liability reported on the Michigan income tax and single business tax (or its successor tax or taxes) annual returns filed following the close of such fiscal year. If the excess is less than 1%, this excess may be transferred to the State Budget Stabilization Fund . . . .

Furthermore, the state is prohibited from spending any current-year revenue in excess of the limit established in Section 26 by Article IX, Section 28.

The final FY 2002-03 revenue limit calculation indicated that state revenue collections were \$4.18 billion below the revenue limit. In addition, for FY 2003-04 through FY 2004-05, state revenues are estimated to be substantially below the revenue limit, by \$4.56 billion, and \$5.64 billion respectively.



# RISKS AND UNCERTAINTIES

An economic forecast is based on the best information available at the time the forecast is made. Because information and foresight are not perfect, risks and uncertainties are inherent in any forecast. The key risks in this forecast stem predominantly from uncertainties surrounding the labor market and productivity, the price of oil, intense competition in the motor vehicle industry, and uncertainties with the retail trade sector.

## ***Labor Market and Productivity***

Recovery from the most recent national recession has been characterized by relatively anemic economic growth and high productivity gains with an extended weak labor market. While national wage and salary employment posted an average gain of 198,200 during the first ten months of 2004, Michigan wage and salary employment lost, on average, 1,870 jobs over this period.

Michigan's wage and salary employment has generally declined since the first quarter of CY 2001—the most recent data indicate that Michigan wage and salary employment has continued to trail downward. In October, however, the state's wage and salary employment grew by 15,000, offsetting the September decline of 12,000. Relative to a year ago, transportation equipment was down 3.3% and trade, transportation, and utilities, were down 2.8% (primarily due to retail trade).

Productivity increased 2.7% on average between 1998 and 2001. After increasing at 4.3% in CY 2002 and 4.5% in CY 2003, output per hour is estimated to increase 4.1% in 2004 and 2.5% in 2005. Businesses will continue to push for productivity increases, but increased hiring is expected to take over as the main factor in producing more output at the national level. Key to Michigan's job recovery, productivity gains in manufacturing and durable manufacturing have outpaced overall productivity—and this trend is expected to continue.

This forecast assumes that the national labor market will continue to improve, while Michigan employment will remain flat in the first quarter of 2005, then expand very slowly throughout the rest of 2005. Michigan wage and salary employment is expected to increase only by 25,000 jobs or 0.6% in CY 2005. If the labor market does not turn around as estimated, both the national economy and Michigan's economy could grow slower than anticipated and revenue growth would be adversely affected.

## ***Oil Prices***

Oil prices are forecast to decline throughout 2005 and to average \$38/barrel by the fourth quarter of 2005. This price is significantly higher than the previously estimated long-term trend price of oil. Both strong global demand (especially in China) and supply shocks (attacks on Iraqi pipelines, political turmoil in Venezuela and Nigeria, and hurricanes in the Gulf of Mexico) have contributed to the recent high oil prices.

Oil prices affect the economy primarily through allocation of disposable income—because more income is used for energy (gasoline, fuel oil, and natural gas), less is used for all other items. Oil prices could fall below the estimated level, causing economic growth to be stronger than anticipated. On the other hand, oil prices may be higher than estimated, resulting in economic growth below the forecasted level.

### ***Michigan's Motor Vehicle Industry***

The level and composition of light motor vehicle sales is a key component of Michigan's economy. Light vehicle sales were 16.6 million units in CY 2003 and are forecast to be 16.7 million in CY 2004 and CY 2005. The import share of light vehicles was 19.9% in CY 2003 and is forecast to edge up slightly to 20.1% in CY 2004 and 20.6% in CY 2005. The value of the dollar relative to other currencies is expected to continue to decline, which will make import vehicles less attractive.

Although a higher level of domestically-produced motor vehicle sales would generally be considered positive for Michigan, the benefit to Michigan may not materialize. As reported by the *Detroit News*, the 2003 market share of the big three auto manufacturers—General Motors, Ford, and DaimlerChrysler—declined to an all-time low of 60.3%. In addition, Michigan motor vehicle production declined 3.7% in FY 2002-03 and 4.9% in FY 2003-04.

Transplants (vehicles with a foreign nameplate that are made in the U.S.) have steadily gained in market share over the past several years. These transplants are expected to increase production capacity in the next few years, while the big three are expected to reduce capacity.

If the Michigan-produced market share of motor vehicles is less than anticipated, Michigan's economy and revenue growth will be lower than estimated.

### ***Michigan's Retail Trade Industry***

The weak state labor market and pressures for productivity gains have contributed to retail trade employment losses in Michigan in the last few years. In addition, the timing and location of any store closings or job reductions in Michigan due to the recent announcement of the Kmart-Sears merger have yet to be announced.

The degree to which retail trade employment is higher or lower than anticipated will affect state revenue growth.





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